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**IN THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF IOWA  
Central Division**

**SMITHFIELD FOODS, INC.,  
MURPHY FARMS, LLC, and  
PRESTAGE-STOECKER  
FARMS, INC.,**

**Plaintiffs,**

**v.**

**THOMAS J. MILLER, Attorney  
General of the State of Iowa in His  
Official Capacity,**

**SERVE: Second Floor  
Hoover Building  
1305 E. Walnut St.  
Des Moines, Iowa 50319**

**Defendant.**

**Civil Action No.**

**02-02-CV-00324**

**COMPLAINT FOR DECLARATORY AND PROSPECTIVE  
INJUNCTIVE RELIEF PURSUANT TO 42 U.S.C. § 1983**

Plaintiffs, Smithfield Foods, Inc., Murphy Farms, LLC, and Prestage-Stoecker Farms, Inc. state the following as their Complaint for Declaratory and Prospective Injunctive Relief Pursuant to 42 U.S.C. § 1983 against defendant, Thomas J. Miller, Attorney General of the State of Iowa, in his official capacity:

**NATURE OF THE LAWSUIT**

1. This suit is brought by plaintiffs, Smithfield Foods, Inc., Murphy Farms, LLC, and Prestage-Stoecker Farms, Inc. for a declaration that § 9H.2 of the Code of Iowa (2002) on its face, in its purpose, and in its effect violates the dormant Commerce Clause, Article I, Section 8, Clause 3; unconstitutionally impairs existing contracts in violation of Article I, Section 10,

Clause 1; and unconstitutionally imposes a taking without just compensation in violation of Amendments V & XIV of the Constitution of the United States. Plaintiffs also seek prospective injunctive relief to prevent defendant's threatened enforcement of Iowa Code § 9H.2, as amended, against them.

### **THE PARTIES AND THEIR INTERESTS**

2. Smithfield Foods, Inc. ("Smithfield") is a corporation organized under the laws of Virginia with its principal place of business at 200 Commerce Street, Smithfield, Virginia. Through its purchase of meat processing facilities like John Morrell & Co. and Gwaltney of Smithfield, Ltd., and pork producers like Brown's of Carolina, Inc., Circle Four LLC, Carroll's Foods, Inc., and Murphy Farms, Inc., Smithfield has been able to adopt an advanced business model of vertical integration. This approach has allowed Smithfield to achieve and maintain a high degree of quality control in its efforts to use superior genetics, controlled feeding, and advanced animal husbandry to produce a consistently excellent line of value-added pork products and processed meats for national and international consumption.

3. In 1990, after Smithfield acquired the exclusive U.S. rights to the genetic lines of 2,000 sows that had been specially bred by the National Pig Development Company in Great Britain, Smithfield transported these animals to the United States with the idea that they would form the nucleus of a herd with significantly leaner meat than any other group of commercially raised hogs.

4. By 1996, Smithfield and Carroll's Foods, Inc. had successfully produced enough hogs from this herd to be able to begin selling Smithfield Lean Generation Pork®, which was the first fresh pork product to be certified by the American Heart Association for its low fat, sodium,

and cholesterol content. Smithfield sold more than 100 million pounds of Smithfield Lean Generation Pork® in FY 2001.

5. Smithfield has utilized vertical integration to develop consistent, branded products that are held in high demand by consumers and retailers. Using this concept, Smithfield has experienced less earnings volatility as prices have fluctuated and obtained stronger operational efficiencies, which in turn has allowed Smithfield, through ongoing research and development, to meet national and international demands for nutritious and flavorful products. These benefits have also accrued to the family farms and farmers who contract with plaintiffs.

6. Four years ago, branded products like Smithfield Lean Generation Pork® accounted for 13% of Smithfield's fresh pork volume. The success of that brand, together with additional Smithfield branded items like Gwaltney Tender Perfection and John Morrell Tender N Juicy, have now increased this figure to 40%. Today, Smithfield annually produces approximately 12 million hogs and processes approximately 20 million hogs. Through hog raising and pork processing subsidiaries, Smithfield can completely control the quality of its products. Starting with nutritional diets and the exceptionally lean genetic lines of its herds, and going through the final processing, packaging, and delivery of fresh pork, ham, bacon, sausage, luncheon meat, shoulders, and precooked/case-ready products, Smithfield's business serves individual consumers, supermarkets, grocery stores, and retailers like Wal-Mart.

7. Smithfield's need to achieve and maintain quality control over its products is ultimately consumer-dictated. With well-publicized outbreaks of mad cow disease and hoof-and-mouth disease, food safety has become a top concern for individuals and stores when they choose meat products and suppliers. Thus, the ability to furnish as much data and information as

possible about a finished pork product's origins – a concept known as traceability – has given Smithfield a valuable competitive advantage. Because of vertical integration, Smithfield can tell its customers important information about its hogs – *e.g.*, where they were raised, what they were fed at every stage of their growth cycle, their genetic makeup, and whatever medical regimens they have had.

8. Vertical integration also benefits the market for Smithfield's popular case-ready products, which provide supermarket chains, grocery stores, and retailers with significant advantages over the traditional methods for merchandizing fresh pork. These advantages include greater freshness and food safety, substantial cost reduction, and the convenience of being able to sell pre-packaged and pre-priced products.

9. Murphy Farms, LLC is a limited liability company organized under the laws of Delaware with its principal place of business at 4134 U.S. Highway 117, Rose Hill, North Carolina, 28458. Murphy Farms, LLC was created in 2001 and is the successor in interest to Murphy Farms, Inc. Murphy Farms, LLC owns nearly one-half of the approximately 700,000 sows that Smithfield has in the United States.

10. In September 1999, when Smithfield announced that it intended to acquire Murphy Farms, Inc., the Attorney General for the State of Iowa objected by letter to this transaction on the basis that Smithfield's purchase of Murphy Farms, Inc.'s Iowa-based assets would violate § 9H.2 of the Code of Iowa. At that time, Iowa Code § 9H.2 purported to make it illegal for Smithfield as a pork processor to "contract[] for the care and feeding of . . . swine in this state" if it ultimately slaughtered those hogs. Plaintiffs here are challenging Iowa Code § 9H.2, as amended, as violative of the Constitution of the United States.

11. Prestage-Stoecker Farms, Inc. ("Prestage-Stoecker") is a corporation organized under the laws of Iowa with its principal place of business at 301 Alexandria Avenue, Ames, Iowa 50010. Prestage-Stoecker, then called Stoecker Farms, Inc., acquired the Iowa-based assets of Murphy Farms, Inc. in January 2000. These assets are operated by Prestage-Stoecker in the following manner. Prestage-Stoecker has a contract with Murphy Farms, LLC to purchase feeder pigs with the Pig Improvement Company (PIC) genetic line. These feeder pigs are brought into Iowa from out-of-state. Prestage-Stoecker has contracts with approximately 260 Iowa farms who finish the hogs on their farms using feed, medicines, and other supplies provided by Prestage-Stoecker. These farms are paid a guaranteed price for their services, plus incentives. Prestage-Stoecker then sells the finished pigs to IBP, inc. (which ultimately processes them) at a premium price. The purchase price for the feeder pigs sold by Murphy Farms, LLC to Prestage-Stoecker is the price received by Prestage-Stoecker for the finished hogs, less Prestage-Stoecker's costs of production, overhead costs, and an additional \$0.25 per head. This arrangement permitted Smithfield to structure its operations and contractually create the next best thing to vertical integration while also complying with the terms of Iowa Code § 9H.2.

12. In January 2000, Smithfield acquired the non-Iowa-based assets of Murphy Farms, Inc., and the Attorney General for the State of Iowa sued Smithfield in the Iowa District Court in and for Humboldt County in a civil action styled State of Iowa ex rel. Miller v. Smithfield, Equity No. EQCV 016629, claiming violation of Iowa Code § 9H.2.

13. During its 2000 session, the Iowa General Assembly amended Iowa Code § 9H.2. As amended, effective July 1, 2004, the statute had the purpose and effect of prohibiting any

person or entity processing any hogs anywhere in the world from contracting for the care and feeding of swine in Iowa unless that person or entity is a cooperative association organized under the laws of Iowa or unless that entity is an out-of-state cooperative association whose ownership includes an Iowa cooperative association contracting for the care and feeding of swine in Iowa with an Iowa resident.

14. In 2002, following the February decision in State of Iowa ex rel. Miller v. Smithfield, wherein the Iowa District Court held that Stoecker Farms, Inc.'s formation was not a sham transaction and that neither Smithfield nor Prestage-Stoecker was in violation of Iowa Code § 9H.2, the Iowa General Assembly again amended Iowa Code § 9H.2 to target plaintiffs' operations in Iowa for abolition effective July 1, 2004, and to make vertical integration legal only for Iowa cooperative associations or for other cooperative associations with prescribed Iowa ownership and activities. Effective July 1, 2004, plaintiffs are exposed to penalties of up to \$25,000 per day if they continue their present business.

15. The Honorable Thomas J. Miller is the Attorney General of Iowa. Under Iowa Code § 9H.3, he is authorized to "institute suits on behalf of the state to prevent and restrain" any alleged violations of Chapter 9H of the Code of Iowa. By letter dated March 6, 2002 from Stephen Moline, Assistant Attorney General, the Iowa Attorney General's Office formally put plaintiffs on notice that it would deem them to be in violation of Iowa Code § 9H.2 effective July 1, 2004, and that it would "pursue the remedies provided by Iowa Code section 9H.3" "[s]hould [they] fail to take action necessary to comply with Iowa Code section 9H.2."

#### **JURISDICTION AND VENUE**

16. Jurisdiction is conferred upon this Court by 28 U.S.C. § 1331, and by 28 U.S.C. § 1343(3)-(4) in that this suit complains of the denial of federal constitutional rights under color of state law forbidden by 42 U.S.C. § 1983.

17. Authority to order a reasonable award of attorneys' fees and costs is conferred upon this Court by 42 U.S.C. § 1988.

18. Declaratory relief is proper in this case of actual controversy under 28 U.S.C. § 2201(a).

19. Venue is proper in this Court under 28 U.S.C. § 1391(b)(1)-(2) because defendant resides in this judicial district and because a substantial part of the events giving rise to these claims occurred in this judicial district.

### **FACTUAL BACKGROUND**

#### **Hog Production in the United States and the State of Iowa**

20. Iowa is both widely and historically regarded as the largest hog producing state in the United States. On December 1, 1980, there were approximately 64.5 million hogs in inventory in this country, approximately 25% of which resided in Iowa. These figures fell in the 1980s, but rebounded in the 1990s. On December 1, 2001, federal officials reported an estimated 59 million hogs in the United States. Approximately 25% of these animals resided in Iowa (down from a high of 28% in 1981 but up from a low of 22% in 1996). Iowa also had an estimated 18% of the nation's 6.2 million breeding inventory on December 1, 2001. Ninety-two percent of Iowa's ninety-nine counties have more pigs than people. Approximately 96% of the production from Iowa pork processing plants is consumed outside of Iowa.

21. In 1980, approximately 10% of all hog farming operations in the United States were located in Iowa. This figure increased to a high of 15% during 1992-95 and 1997-99, and stood at 13% in 2001.

22. During the period 1980-2001, approximately 23%-33% of all commercial hogs slaughtered in the United States were processed in Iowa. This figure stood at 28% in 2001.

23. In 1993, approximately 24% of all operations with 2,000+ hogs were located in Iowa. This number fluctuated from a low of 18% in 1996 to a high of 28% in 1999, and stood at 24% in 2001.

24. In 1996, approximately two-thirds of the United States' hog inventory was produced on approximately 12,000 farms with a one-time hog inventory of 1,000+ hogs each. There were approximately 3,000 of these farms in Iowa, including the estimated 260 contract farms that finish hogs for Prestage-Stoecker.

25. Pigs born in other states are often sent to Iowa for finishing by the entities that own them. Approximately 10% of the feed necessary to produce a hog is consumed by the breeding herd, with another 10% being consumed in the nursery and the remaining 80% being used to finish the hogs. Iowa has become widely known as a preferred hog finishing state because corn there is cheaper than in most other markets. In many instances, it is less expensive to ship a feeder pig to Iowa for finishing than it is to ship corn from Iowa to the hog. In 2001, approximately 12.9 million slaughter hogs, feeder pigs, and weaned pigs were shipped to Iowa for finishing and processing from elsewhere. This represented approximately 48% of all such shipments in the United States.



26. In 2000, an estimated \$2.24 billion in personal income was generated by the hog industry in Iowa, which contributed a total estimated \$3.37 billion of gross state product and an estimated 77,000 jobs to the State of Iowa.

#### Smithfield's Operations

27. Smithfield has the largest daily capacity of any U.S. pork processor, currently accounting for a 21% capacity share. The four largest pork processors accounted for 57% of national capacity in 1999. By comparison, it was reported in 1999 that the nation's top four grain marketing and processing companies controlled 59% of flour milling, 74% of wet corn milling, and 76% of soybean crushing. At that time, the four largest processors of beef and sheep respectively accounted for 80% and 73% of capacity in those markets. The ten largest pork processors accounted for approximately 82% of capacity share in 1997.

28. Smithfield's operations, like those of other pork processors, do not reflect monopoly power according to the Herfindahl-Hirschman index, a measure of market concentration accepted by the United States Department of Justice. The index for the national slaughter market as defined by 38 meat packers in June 2000 is 1,161.6. The index for the national pig production market for 2001 was 1,127.6.

29. Smithfield's business organization includes meat processing, international, and hog production groups that contribute and cater to branded products, food service companies, case-ready products, and other markets. Approximately 75% of Smithfield's processing business is geared towards the fully-integrated branded and/or case-ready market. The hallmark of this market is the sale of a branded product like Smithfield Lean Generation Pork® which has a high, recognized degree of standardization, traceability, accountability, and quality. The demand for

such branded products is consumer-driven and leads Smithfield's customers to insist on the inclusion of such features in retail products that are sold throughout the world.

30. The State of Iowa is fully aware of the economic dynamics of this market. The economic trend toward vertical integration is confirmed by an advertising supplement for Iowa 2010: A Strategic Planning Initiative, a comprehensive plan for the State's future that was compiled through the initiative of Governor Thomas Vilsack. A related advertising supplement, which was paid for by the Governor's Strategic Planning Council, states that

[a]griculture is the soul of Iowa, but its long-term growth rate is less than half the rate of other industries. The reliance on traditional agricultural commodities and markets will shrink as the forces of an integrated world economy continue a 30-year downward spiral of raw commodity prices. Research suggests this will be especially true for food prices as production rates increase in emerging market countries. Open markets for commodity crops will diminish in favor of highly integrated systems driven by consumer demand. While dramatically altering the face of traditional farming practices, these changes provide a unique opportunity for Iowa to reinvent agriculture and its role in feeding the world.

Iowa 2010 – The New Face of Iowa: Embracing Iowa's Values – Shaping Iowa's Future 4 (2000 advertising supplement). Iowa 2010 has as one of its stated goals that Iowa will be "known as the consumer-driven life science capital of the world, aligning producers with consumers, diversifying the agricultural economy and increasing farm income." *Id.*

31. Smithfield began its activities in the vertically integrated market segment by using its own genetically uniform breeding stock. Through Smithfield-owned farms and farms of contract farmers, Smithfield provides for a uniform methodology whereby pigs are raised according to an established cycle.

32. In this cycle, pigs are born approximately 114 days after gestation. Their shared immunity with the sows ends after approximately seventeen days. The pigs, which then weigh approximately 10-12 pounds, are moved to a nursery to discourage exposure to illness as their immunity fades. After being fed for seven weeks on four different diets in the nursery, these pigs weigh 45-50 pounds and are then transported to farms for finishing. There, they spend an average of 140 days on four diets, achieving a final weight of 245-260 pounds before being sent to a slaughterhouse for processing.

Smithfield's Purchase of Murphy Farms, Inc.

33. On September 2, 1999, Smithfield announced its intent to acquire all of the capital stock of Murphy Farms, Inc. for the price of approximately 10 million shares of Smithfield common stock and the assumption of approximately \$170 million of term debt and other liabilities. At that time, Murphy Farms, Inc. was not itself a processor, nor was it affiliated with any processor. In 1998 and 1999, Murphy Farms, Inc. and other pork producers had suffered operating losses due to a decline in market prices, while Smithfield had posted net positive income due to its vertical integration business model.

34. This acquisition included an \$80 million premium to purchase Murphy Farms, Inc.'s Iowa-based assets. These assets had significant value to Smithfield because Murphy Farms, Inc. had demonstrated its ability to raise pigs in Iowa at a cost far below that for any other location throughout the United States in which Murphy Farms, Inc. did business. This savings was attributed to Murphy Farms, Inc.'s good management practices, as well as to lower feed and freight costs attributable to pigs and grain being in the same location.

35. This premium was calculated based upon the fact that the cost of raising hogs in Iowa would be three cents a pound – \$3 per hundredweight – less than the cost of raising hogs in the East. Smithfield then multiplied the volume of hogs being sold in the Midwest, capitalized at 5.5 times (an earnings stream), and decided that the Iowa-based operations of Murphy Farms, Inc. were worth the \$80 million premium over the book value of the assets.

The Iowa Attorney General's Opposition to the Smithfield-Murphy Farms, Inc. Deal

36. On September 3, 1999, Stephen Moline, Assistant Attorney General, sent a letter to Smithfield's Secretary and Associate General Counsel, stating in relevant part the following:

On Thursday, September 2, 1999, I received a copy of a press release in which Smithfield Foods announced that it had reached an agreement in principle to acquire Murphy Farms, Inc. As I am sure you are aware, Murphy Farms, Inc. contracts for the care and feeding of swine here in Iowa. Based on our conversations and correspondence surrounding Smithfield's acquisition of Carroll Foods of the Midwest, I know that Smithfield is aware that this acquisition raises many issues involving Iowa's corporate farming statute as found in Iowa Code chapter 9H.

Specifically, I refer you to Iowa Code section 9H.2, which prohibits a processor from contracting for the care and feeding of the swine in this state. Therefore, Smithfield's acquisition of Murphy's Iowa operation would be in violation of this prohibition. As a result of this concern, our office must know how Smithfield intends to address this situation as part of their acquisition of Murphy Farms, Inc.

37. At that time, Iowa Code § 9H.2 stated in relevant part:

[i]n order to preserve free and private enterprise, prevent monopoly, and protect consumers, it is unlawful for any processor of beef or pork or limited partnership in which a processor holds partnership shares as a general partner or partnership shares as a limited partner, or limited liability company in which a processor is a member, to own, control or operate a feedlot in Iowa in which hogs or cattle are fed for slaughter. In addition, a processor shall not directly or indirectly control the manufacturing, processing, or

preparation for sale of pork products derived from swine if the processor contracted for the care and feeding of the swine in this state.

This section of Iowa's anti-corporate farming scheme specifically exempted cooperative associations organized under the laws of Iowa from this statutory ban, and allowed out-of-state cooperative associations to farm in Iowa only if they had at least one Iowa cooperative association in their membership and contracted with a member of that Iowa cooperative association who was "actively engaged in farming." The law at the time did not bar a processor from moving pigs in interstate commerce to be finished in Iowa as long as the processor did not directly contract for finishing and did not itself process the pigs it contracted to finish in Iowa.

38. In September 1999, approximately 75% of Murphy Farms, Inc.'s Midwest operations were concentrated in Iowa, where Murphy Farms, Inc. had been contracting with approximately 260 independent farms for the care and finishing of its hogs. Ownership of the hogs being finished remained with Murphy Farms, Inc., which filed U.C.C. Financing Statements on these hogs. Murphy Farms, Inc. had also entered into a contract whereby it would provide quality hogs to IBP, inc. for slaughter and processing. These hogs have an average weight of 262 pounds. Under this contract, IBP would pay Murphy Farms, Inc. the market price for finished hogs, plus an additional \$2 per hog premium.

39. IBP, inc. has no corporate relationship or affiliation with Smithfield.

40. Smithfield's proposed acquisition of Murphy Farms, Inc.'s Iowa-based assets (which included these grower contracts) did not violate Iowa Code § 9H.2 because IBP, inc., not Smithfield, would "control the manufacturing, processing, or preparation for sale of pork products derived from [these] swine . . . ."

**The Sale of Murphy Farms, Inc.'s Iowa Assets to Stoecker Farms, Inc.**

41. In September 1999, Jerry Godwin, President and Chief Executive Officer of Murphy Farms, Inc., began (without Smithfield's knowledge) to discuss the potential sale of Murphy Farms, Inc.'s Iowa-based assets to Randall D. Stoecker. These talks were hypothetical given that Smithfield intended to purchase these assets as part of its overall acquisition of Murphy Farms, Inc.

42. Although Murphy Farms, Inc. was proceeding on the basis that the Smithfield transaction would not violate Iowa Code § 9H.2 or the federal Hart-Scott-Rodino Act, Jerry Godwin and Randall Stoecker further discussed the possibility that Stoecker might purchase Murphy Farms, Inc.'s Iowa-based assets in the event complications arose from those laws.

43. Smithfield and the individual shareholders of Murphy Farms, Inc. entered into an Acquisition Agreement and Plan of Reorganization effective November 15, 1999 (and later amended on January 1, 2000) to facilitate the pending business deal.

44. On December 21, 1999, shareholders at a special meeting approved the issuance of approximately 10 million additional shares of Smithfield common stock in anticipation of its intended purchase of Murphy Farms, Inc.

**The Iowa Attorney General's Continued Opposition to the Smithfield-Murphy Deal**

45. In a second letter to Smithfield's Secretary and Associate General Counsel dated December 3, 1999, Stephen Moline renewed "the Iowa Attorney General's request for information concerning [the proposed transaction between Smithfield and Murphy Farms, Inc.] . . . so [the Attorney General's Office] can meet [its] statutory obligations found in Iowa Code

chapter 9H.” This letter threatened that if Smithfield did not provide such information, “it will be necessary for us to pursue other more formal alternatives.”

46. On December 16, 1999, Moline sent a letter to Smithfield’s Iowa counsel requesting that Smithfield provide information concerning its proposed acquisition of Murphy Farms, Inc. to the Attorney General’s Office by December 17. Moline reiterated that “if we do not receive a complete response by that date, it will be necessary for our office to use more formal means to prevent the apparent violation of Chapter 9H resulting from your client’s acquisition of Murphy Farms, Inc.”

47. Smithfield’s Iowa counsel responded on December 17, 1999, and provided a copy of the master agreement memorializing the proposed transaction. Smithfield also provided the Attorney General’s Office with assurances:

Following the closing, Smithfield’s operations and Murphy’s operations will operate almost exactly as they are operating prior to the transaction – Murphy’s will simply have different ownership. Their day-to-day operations in the State of Iowa, however, and the impact of such operations, will remain substantially the same.

Murphy’s will not, after the closing of the transaction, own, control or operate any feedlots within the State of Iowa. Rather, Murphy’s hogs will be finished by independent third parties under written finishing contracts as negotiated on a case-by-case basis. The single company-owned finishing facility currently owned by Murphy’s is being sold to an independent third party prior to the closing of the transaction, in order to comply with Iowa law.

All hogs raised by Murphy’s and finished in the State of Iowa by independent third parties will be processed by IBP under a long-term processing contract currently in place between IBP and Murphy’s. IBP is not directly or indirectly controlled by Smithfield. Neither Smithfield nor any Smithfield subsidiary or affiliate will process such hogs.

48. Nevertheless, the Attorney General's Office continued to assert its belief that Iowa Code § 9H.2 barred Smithfield from purchasing the Iowa-based assets of Murphy Farms, Inc. In a letter dated December 23, 1999 to Smithfield's Iowa counsel, Mr. Moline disputed the legality of the transaction, stating the Office's opinion that this business deal would result in

a probable violation of Iowa Code section 9H.2. Specifically, section 9H.2 not only prohibits processors like Smithfield from owning feedlots in Iowa, it also prohibits them from controlling or operating feedlots in Iowa. I've included an Iowa Attorney General opinion that addresses this issue. Given the degree of operational oversight that will be exercised by Smithfield Foods pursuant to the express terms of Murphy Farm's production contracts, the acquisition . . . will violate the prohibitions contained in Iowa Code section 9H.2.

49. Smithfield's Iowa counsel responded by letter dated January 4, 2000. In this letter, Smithfield memorialized its understanding that the Attorney General's Office "will refrain from taking or filing any kind of enforcement or injunctive action intended to hinder, delay or prevent the consummation of the acquisition transaction without first providing prior notice . . . ."

50. Throughout this period, Smithfield and the Attorney General's Office had several meetings and dialogues in an effort to resolve informally the dispute over whether Iowa Code § 9H.2 prohibited this transaction. Although Smithfield had a reasonable and legitimate business expectation that it could acquire Murphy Farms, Inc.'s Iowa-based assets without violating Iowa Code § 9H.2, it nevertheless agreed to modify the proposed deal and remove certain terms that the Attorney General had deemed problematic to facilitate the purchase.

The Formation of Stoecker Farms, Inc.



51. On January 20, 2000, Stoecker Farms, Inc. was formed under the laws of Iowa. Under its Articles of Incorporation, Stoecker Farms, Inc. was authorized to issue up to one million shares of no par value common stock. The Minutes of Informal Action by Consent of Incorporator state that Stoecker Farms, Inc. was duly organized as a "'family farm corporation' within the meaning of Iowa Code Chapter 9H, and in accordance with the Iowa Business Corporation Act." Randall Stoecker was issued 100 shares of common stock in exchange for his initial \$10,000 capital contribution. Stoecker was issued an extra 5,000 shares of common stock later that year in exchange for his additional \$500,000 capital contribution to Stoecker Farms, Inc.

52. That same day, Randall Stoecker resigned his position as head of the Midwest division of Murphy Farms, Inc. Murphy Farms, Inc. later rehired Stoecker in February 2000 at a reduced salary to manage its non-Iowa-based Midwest operations.

53. Stoecker Farms, Inc. had no corporate affiliation with either Smithfield or Murphy Farms, Inc. This conclusion was later confirmed by the independent accounting firm of McGladrey & Pullen, which audited the accounting practices and procedures at Stoecker Farms, Inc. and found no such affiliation.

The Attorney General of Iowa Sues in State Court to Stop the Smithfield-Murphy Deal

54. On January 21, 2000, Smithfield notified the Attorney General of Iowa by letter to Stephen Moline, Assistant Attorney General, that its projected acquisition of Murphy Farms, Inc. would close no sooner than January 25, 2000.

55. Shortly thereafter, negotiations with the State reached an impasse, prompting Jerry Godwin and Randall Stoecker to renew their talks about a business deal between Murphy Farms, Inc. and Stoecker Farms, Inc.

56. On January 24, the Attorney General of the State of Iowa filed a Petition and Request for Temporary, Preliminary, and Permanent Injunction (the "Petition and Request") against Smithfield in the Iowa District Court in and for Humboldt County.

57. In the Petition and Request, the Attorney General asserted that "[u]pon completion of its acquisition of Murphy Farms, Inc., it is believed that Smithfield, a 'processor' as defined in Iowa Code section 9H.1(19), will own, control, or operate a feedlot in Iowa in which hogs or cattle are fed for slaughter in numerous Iowa counties, including Humboldt County, in violation of Iowa Code section 9H.2." (Pet. and Request, ¶ 24.)

58. This conclusion was based primarily upon the contention that the sale of Murphy Farms, Inc.'s Iowa-based assets as proposed would allow Smithfield to exercise and "retain authority" over "the approximately 300 Murphy Farms, Inc., sites located in Iowa." (Pet. and Request, ¶ 16.) Specifically, the Attorney General listed twenty-two operational aspects of hog farming that Smithfield would allegedly control following its purchase. (*Id.*, ¶ 16(A)-(V).)

59. The Petition and Request sought the issuance of temporary, preliminary, and permanent injunctions to prevent Smithfield "from acquiring the assets of Murphy Farms, Inc., or any related entity, located in Iowa until [Smithfield] has established to the Court that it has complied with the provisions of Iowa Code section 9H.2." (*Id.*, Prayer for Relief, ¶ (a)-(c).)

60. That same day, the Iowa Attorney General's Office moved for a temporary injunction, which the Iowa District Court also granted that same day. A hearing on the request for a preliminary injunction was set for February 10, 2000.

The Sale of Murphy Farms, Inc.'s Iowa-Based Assets to Stoecker Farms, Inc.

61. In light of the State's threatened action and perceiving that time was of the essence, Murphy Farms, Inc. agreed to sell its Iowa-based assets to Stoecker Farms, Inc.

62. Under the terms of the sale, Stoecker Farms, Inc. bought all of Murphy Farms, Inc.'s grower contracts, feeder pig and hog inventory, feed, and medical supplies. Murphy Farms, Inc. also assigned its contract with IBP, inc. for hogs finished in Iowa to Stoecker Farms, Inc., which paid for all of these items by delivering a promissory note to the seller.

The Subsequent Sale of Murphy Farms, Inc. to Smithfield

63. On January 28, 2000, Smithfield finally acquired all of the capital stock in Murphy Farms, Inc. at a higher price than was originally proposed. Rather than issue 10 million additional shares of Smithfield common stock and assume approximately \$170 million of Murphy Farms, Inc.'s term debt and other liabilities, Smithfield ultimately issued 11.1 million shares and assumed approximately \$203 million in debt and liabilities.

64. Because Murphy Farms, Inc. did not own or have any Iowa-based assets at that time, Smithfield and the Iowa Attorney General's Office stipulated that the January 28, 2000 sale did not violate the Iowa District Court's temporary injunction.

65. Murphy Farms, Inc. and Stoecker Farms, Inc. also entered into a Feed Purchase Agreement, a Feeder Pig Purchase Agreement, and an Employee Service Agreement whereby

Murphy Farms, Inc. agreed to assign some of its employees to help run Stoecker Farms, Inc.'s operations. These agreements are still valid and operational.

66. The ultimate effect of these agreements was to allow Murphy Farms, Inc. to provide feeder pigs from out-of-state to Stoecker Farms, Inc., which in turn contracted with the 260 grower farms to finish these pigs for ultimate sale to IBP, inc. IBP, inc. would then slaughter and process the pigs. IBP, inc. would pay Stoecker Farms, Inc. the value of the slaughtered hogs. After paying its production costs, Stoecker Farms, Inc. would remit the balance of the revenue received from IBP to Murphy Farms, Inc., retaining an additional \$0.25 per head for itself. Title, insurable interest, and the risk of loss of the feeder pigs were held by Stoecker Farms, Inc., with Murphy Farms, Inc. retaining a security interest.

The Attorney General's First Amended Petition

67. On February 3, 2000, the Attorney General filed a First Amended Petition and Request for Temporary, Preliminary and Permanent Injunction (the "First Amended Petition") against Smithfield and Stoecker Farms, Inc., contending that Smithfield was "in total and complete control of Stoecker's finances" because Stoecker Farms, Inc. had allegedly obtained promissory notes "without any financial input or wherewithal of its own." (First Am. Pet., ¶¶ 31-32.) The First Amended Petition further claimed "[o]n best information and belief" that these transactions involving Smithfield, Murphy Farms, Inc., and Stoecker Farms, Inc. amounted to "a sham" inasmuch as they were designed to allow Smithfield to control Iowa-based feedlots in violation of Iowa Code § 9H.2. (*Id.*, ¶¶ 34-35.)

68. The Attorney General sought the appointment of a Special Master to investigate these transactions and report his findings to the court so that it could reach "an appropriate final

decision.” (*Id.*, Prayer for Relief, ¶ (a)). The Attorney General also requested entry of an order requiring Stoecker Farms, Inc. “to disgorge all its holdings” because they were “in violation of Iowa Code Chapter 9H,” and prohibiting Smithfield “from directly or indirectly participating in any manner with the operation or control of Iowa feedlots.” (*Id.*, ¶ (b)-(c).)

69. The Iowa District Court granted the appointment of the Special Master, charging him as follows:

The Special Master shall do any and all things reasonably necessary to discharge his duties, as prayed for in the First Amended Petition, including the conduct of meetings and fact-finding endeavors so as to enable the Special Master to file a Report with this Court, detailing the factual circumstances and background and effect of any and all financial and business transactions and arrangements among and between Smithfield Foods, Inc., Murphy Family Farms, Stoecker Farms, Inc., Randall Stoecker, and/or other parties, in the context of whether any and all such transactions are in compliance with or violative of the provisions of Iowa Code Chapter 9H (1999). Pursuant to I.R.C.P. 209, the Special Master is vested with the power, authority, and responsibility to regulate all proceedings before him, to administer oaths and to do all acts and take all measures appropriate for the efficient performance of the duties of the Special Master, and to compel production before him of any witness or party or documents and tangible things.

(Order Continuing Temp. Inj. and Appointing Special Master, ¶ 2.)

70. On or about February 24, 2000, Smithfield answered the First Amended Petition, denying throughout that Iowa Code Chapter 9H or Iowa Code § 9H.2 regulated its activities and that the transactions at issue violated these statutes. (*See, e.g.*, Answer and Affirmative Defenses, ¶¶ 5-20, 26-30.)

Legislative Changes to § 9H.2 During the 2000 Session

71. During the 2000 session, the Iowa General Assembly enacted Senate File 2349 ("An Act Prohibiting a Processor from Contracting for the Care and Feeding of Swine in This State, Making Penalties Applicable, and Providing an Effective Date"), a severely retroactive law that was narrowly tailored to harm Smithfield and its vertically integrated business operations.

72. Senate File 2349 amended Chapter 9H of the Iowa Code in four ways.

73. First, and most significantly, it amended Iowa Code § 9H.2 to prohibit a processor from being able to "directly or indirectly contract for the care and feeding of swine in this state."

74. Second, it defined the phrase "contract for the care and feeding of swine" as "an oral or written agreement between a person and the owner of swine, under which a person agrees to care for and feed the owner's swine on the person's premises." Iowa Code § 9H.1(6A). The legislature also specified that this new definition would not apply to "an agreement for the sale or purchase of swine." *Id.*

75. Third, it expanded the statutory exemption in Iowa Code § 9H.2 for Iowa cooperative associations to include cooperative associations organized under Chapter 501 of the Code of Iowa.

76. Finally, it added the following language at the end of Iowa Code § 9H.2:

A processor which is in compliance with this section prior to the effective date of this Act [2000 Iowa Acts, chapter 1048] and which is in violation of this section as a result of this Act shall have until July 1, 2004, to comply with this Act. A processor shall not take action on or after the effective date of this Act which would be in violation of this section.

77. Senate File 2349, "being deemed of immediate importance," was signed by Governor Vilsack on April 5, 2000 and went into effect on that date. 2000 Iowa Acts, ch. 1048, § 3.

78. By enacting Senate File 2349, Iowa state officials announced their intent to impair the contracts that Stoecker Farms, Inc. had purchased from Murphy Farms, Inc. (now a Smithfield subsidiary) beginning July 1, 2004.

79. During its 2001 session, the Iowa General Assembly further demonstrated its intent to harm Smithfield by adopting Senate Concurrent Resolution 26, which urged the Iowa Attorney General's Office to vigorously "enforce the provisions of Code section 9H.2 against processors" in relevant part because "Smithfield Foods, Inc. has financed the acquisition by Stoecker Farms, Inc. of the Iowa assets of [Murphy Farms, Inc.]."

The Formation of Prestage-Stoecker Farms, Inc.

80. In May 2001, Randall Stoecker sold 51% of his stock holdings in Stoecker Farms, Inc. to William Prestage of Prestage Farms, Inc. for \$559,000 – an amount equal to the book value of the shares sold, plus a 10% premium.

81. William Prestage had been active in various aspects of the swine industry for several years (including serving as a member of Smithfield's Board of Directors) and had gained considerable knowledge about its workings. He made a \$2 million unsecured working capital line of credit available for Stoecker Farms, Inc., and further obtained an option to purchase the remaining shares of stock held by Randall Stoecker.

82. This sale came about because Randall Stoecker believed that the litigation against the Iowa Attorney General's Office was hurting Stoecker Farms, Inc.'s business operations.

Stoecker believed that Prestage understood the nature and value of Stoecker Farms, Inc. and had the financial resources to maintain its long-run viability.

83. After this sale of stock was completed, Stoecker Farms, Inc. was renamed Prestage-Stoecker Farms, Inc. ("Prestage-Stoecker"). Randall Stoecker became one of Prestage-Stoecker's directors and its chief operating officer. William Prestage's two sons were named the remaining directors of Prestage-Stoecker.

#### The Attorney General's Second Amended Petition

84. Upon learning about Prestage-Stoecker's formation, the Iowa Attorney General filed a Second Amended Petition and Request for Permanent Injunction (the "Second Amended Petition") on June 27, 2001.

85. In the Second Amended Petition, the Attorney General continued to contend that William Prestage's stock purchase, like the preceding transactions that were covered in the First Amended Petition, was "accomplished for the purpose of creating an appearance of compliance by Smithfield with Iowa Code section 9H.2 . . . ." (Second Am. Pet., ¶ 89.) Likewise, the Attorney General continued to assert that these business deals were actually shams designed to allow Smithfield to own, operate, or control feedlots in violation of Iowa Code § 9H.2. (*Id.*, ¶¶ 90-91.)

#### Additional Proceedings Before the Special Master

86. In July 2001, the parties submitted their First Set of Stipulated Facts to the Special Master.

87. In this document, the Iowa Attorney General's Office conceded that it had "no evidence to contradict the following facts and consent[ed] to the stipulation thereof:"



Under the language of Iowa Code Section 9H.2 that was in effect in January 2000, neither Smithfield nor any of its subsidiaries have from January 2000 until the present been 'involved in the manufacturing, processing, or preparation for sale of pork products derived from swine' produced by Stoecker Farms.

At all times relevant to this case, all swine grown on Iowa 'Feedlots' for Stoecker Farms have been sold to IBP under the IBP Sales Contract. IBP is a 'Processor', and it performed the 'manufacturing, processing or preparation for sale of pork products' derived from the swine produced by Stoecker Farms. *See*, Iowa Code Section 9H.1(19).

Before the sale by [Murphy Farms, Inc.] to Stoecker Farms on January 24, 2000, [Murphy Farms, Inc.] did not violate Iowa Code Section 9H by contracting for the care and feeding of swine in Iowa on Feedlots owned by Iowa growers under the provisions of the [Murphy Farms, Inc.] Grower Contracts and Production Manual.

Since the sale by [Murphy Farms, Inc.] to Stoecker Farms on January 1 [sic], 2000, Stoecker Farms has continued to contract for the care and feeding of swine in Iowa under the Iowa Grower Contracts and Production Manual on Feedlots owned by Iowa growers without material change in such contracts or their administration.

(First Set of Stipulated Facts, ¶ 34(A)-(D).)

#### Issuance of the Special Master's First Report

88. On October 12, 2001, the Special Master filed his First Report under seal with the Iowa District Court.

89. The Special Master also made extensive factual findings based in part upon Proposed Findings of Fact submitted by the parties and also upon his own review of the record.

(First Report at 13-29.)

90. A one-day bench trial was continued to January 2002. In the course of closing argument at trial, the State of Iowa argued that the problem with plaintiffs' business in Iowa is that economic benefit "goes out of state." (Tr., Jan. 11, 2002 at 82.)

#### The Iowa District Court's Final Decision

91. After reviewing the parties' legal briefs and the Special Master's findings, the Iowa District Court held in a 29-page order issued February 5, 2002 that the Attorney General had not proven that any of the transactions at issue were shams or that defendants had at any time violated Iowa Code § 9H.2.

92. The Iowa District Court expressly recognized that the Attorney General's positions were legally untenable.

This Court admires the zeal of the [Iowa Attorney General] in tenaciously attempting to remedy what it perceives as another nail in the coffin of our state's family farms. Unfortunately, as a court in equity, the interpretation given Chapter 9H is determined by what the legislature said, not by what it might have said.

(Order, Judgment, and Decree at 26.)

93. The Iowa Attorney General's office later acknowledged to the press that prosecuting defendants under Iowa Code § 9H.2 as it read at that time "was a difficult case to prove." Associated Press, Attorney General Loses Court Battle over Packer Ownership (Feb. 9, 2002). The Iowa District Court's ruling was not appealed.

#### The Legislature Targets Plaintiffs in the Wake of the Iowa District Court's Decision

94. On March 4, 2002, approximately one month after the Iowa District Court issued its decision, Stewart Iverson, Jr., the Iowa Senate Majority Leader, introduced Senate File 2309 ("An Act Providing for Regulation of Processors, Providing for Penalties, and Providing an

Effective Date and for Retroactive Applicability”), which had the primary purpose and effect of further amending Iowa Code § 9H.2 to retroactively target plaintiffs’ business for abolition.

95. In a newsletter published and distributed that same day, Senator Iverson candidly admitted that his primary motivation for introducing this legislation was to keep Smithfield out of Iowa.

In response to a recent Iowa court decision that let’s [sic] Smithfield Foods finance an Iowa-based hog producer, the Iowa Senate will consider legislation this week to protect farmers from large meatpacking firms. Current Iowa law prohibits beef or pork processors from owning, controlling, or operating a feedlot in Iowa in which hogs or cattle are fed for slaughter.

However, according to ruling made just a few weeks ago by an Iowa District Court judge in Humboldt County, this law was not strong enough to prevent Smithfield Foods Corporation, which processes pork, from providing 100% of the financing [of] a large hog feeding operation in the state managed by Randall Stoecker.

Smithfield Foods is the largest hog producer and pork processor in the world and is a strong advocate for vertical integration – where one company owns both livestock and livestock processing facilities. However, due to concerns that one company could monopolize the livestock industry, Iowa law prohibits processors from owning, controlling, or operating a feedlot in Iowa.

In September of 1999, Smithfield announced its plans to purchase Murphy Family Farms, one of the nation’s largest hog producers, and a company with significant operations in Iowa. To avoid Iowa’s law prohibiting hog ownership by processors, prior to finalizing its purchase of Murphy Family Farms, Murphy’s Iowa based assets were sold to Randall Stoecker, who managed the Iowa operations for Murphy. Even though the purchase price for Murphy’s Iowa assets was \$72 million, Stoecker only had to pay \$10,000 of that price – the remaining purchase price was loaned to him by Smithfield Foods. In addition, Smithfield through its new subsidiary, Murphy Family Farms, supplied Stoecker all of his employees.

Smithfield Foods' goal is to profit from all aspects of the hog industry. They want to make a profit from raising hogs, and make a profit from processing hogs. In Iowa [we] believe it is not healthy for the livestock industry for one company to exercise that much control. Instead, we need to return control to farmers so that they have greater choice and ability to maximize their profits.

We intend to make Iowa law clear once and for all –meatpackers cannot own or control hogs in this state. I don't see how any court could determine that a person who provides 100% of the financing and nearly all the employees for a hog operation does not control that operation. But if a court doesn't consider this control, then we need to update our law to make it clear.

Stewart Iverson, Jr., Iverson's Insights: Protecting Iowa Farmers from Meat Processors (Mar. 4, 2002).

96. The conclusion that Senate File 2309 was specially proposed to ban Smithfield from being able to do business in Iowa is confirmed by other contemporaneous articles and press reports. *See, e.g.*, Associated Press, "Governor Signs Bill Banning Meatpacker Ownership" (Apr. 9, 2002) ("The governor has signed a bill that . . . is intended to close a loophole in state law . . . . Lawmakers became aware of the loophole when [Smithfield] purchased [Murphy Farms, Inc.]. Because of Iowa's ban, Murphy sold its hog operations to a former manager, Randall Stoecker, who managed [Prestage-Stoecker] in Ames . . . . Lawmakers have tried to resolve the situation through a provision that gives Prestage-Stoecker two years to comply."); Associated Press, "Bill Banning Meatpacker Ownership Sent to Governor" (Apr. 1, 2002); Emily Gersema (Associated Press), "House Amends Measure, Imposes Deadline for Prestage" (Mar. 26, 2002) (noting that the House approved 2002 amendments to Iowa Code § 9H.2 by a 94-0 vote and that the amended statute "requires Prestage to sell his portion of Prestage-Stoecker or quit his job with Smithfield"); Emily Gersema (Associated Press), "Livestock Farmers Say

They've Been Made the Enemy" (Mar. 11, 2002) ("The attorney general said the deal [leading to Prestage-Stoecker's formation] was an attempt to circumvent the law . . . . A Humboldt County judge ruled against the attorney general's complaint earlier this year. A bill intended to close that loophole by also prohibiting meatpackers from financing livestock operations won unanimous approval in the Senate last week and has been sent to the House for consideration."); Associated Press, "Senate Passes Bill Preventing Meatpacker Ownership" (Mar. 6, 2002) ("The [Iowa] Senate unanimously approved a bill . . . to ensure that meatpackers cannot own livestock in Iowa . . . . Legislators drafted the bill in response to a case in which meatpacking giant Smithfield Foods, Inc. purchased hog production operations from [Murphy Farms, Inc.]."); Associated Press, "Senate Panel Passes Bill Preventing Meatpacking Ownership" (Mar. 5, 2002) ("[Majority Leader] Iverson said lawmakers are trying to prevent vertical integration, a trend that has been occurring as grocers purchase meatpacking companies and packers begin to raise their own livestock, rather than depend on small family farmers to supply them with hogs, cattle and chickens.").

97. Senate File 2309 passed the legislature on April 1, 2002, on the heels of an intense lobbying campaign seeking its approval. For example, one organization urged its membership to "[c]all and write immediately" to push "legislators to pass this important piece of legislation to prevent vertical integration of the hog industry." Iowa Farmers Union, 2002 Legislative Update: Vertical Integration Bill Passes Senate – House Debate Expected Immediately (visited 6/20/02) <<http://www.iafu.org/02Mar12legupdate.htm>>.

98. On April 9, 2002, Governor Vilsack signed Senate File 2309 into law.

99. In their current business relationship, Smithfield (through Murphy Farms, LLC) provides financing for Prestage-Stoecker's Iowa-based operations. The Iowa District Court expressly held that this was permitted under Iowa Code § 9H.2. However, the 2002 amendments to Iowa Code § 9H.2 now prohibit this business relationship.

100. Iowa Code § 9H.2 now reads in relevant part as follows:

B. For swine, a processor shall not do any of the following:

(1) (A) directly or indirectly own, control, or operate a swine operation in this state.

(B) finance a swine operation in this state or finance a person who directly or indirectly contracts for the care and feeding of swine in this state.

For purposes of subparagraph subdivision (A) and this subparagraph subdivision, all of the following apply:

(I) 'Finance' means an action by a processor to directly or indirectly loan money or to guarantee or otherwise act as a surety.

(II) 'Finance' or 'control' does not include executing a contract for the purchase of swine by a processor, including but not limited to a contract that contains an unsecured ledger balance or other price risk sharing arrangement. 'Finance' also does not include providing an unsecured open account or unsecured loan, if the unsecured open account or unsecured loan is used for the purchase of feed for the swine and the outstanding amount due by the debtor does not exceed five hundred thousand dollars. However, the outstanding amount due to support a single swine operation shall not exceed two hundred fifty thousand dollars.

(C) obtain a benefit of production associated with feeding or otherwise maintaining swine, by directly or indirectly assuming a morbidity or mortality production risk, if the swine are fed or otherwise maintained as part of a swine operation in this state or by a person who contracts for the care and feeding of swine in this state.

(D) directly or indirectly receive the net revenue derived from a swine operation in this state or from a person who contracts for the care and feeding of swine in this state.

As before, Iowa Code § 9H.2 expressly exempted cooperative associations organized under the laws of Iowa from this statutory ban, and allowed out-of-state cooperative associations to vertically integrate in Iowa if they had at least one Iowa cooperative association in their ownership and also contracted with a member of that Iowa association who was “actively engaged in farming.”

101. Senate Bill 2309 defined the term “indirect” at Iowa Code § 9H.1(14A) as “act[ing] or attempt[ing] to accomplish an act through an interest in a business association, through one or more affiliates or intermediaries, or by any method other than a direct approach, including by any circuitous or oblique method.”

102. It also redefined the term “processor,” as it relates to pork, at Iowa Code § 9H.1(19) as any “person who alone or in conjunction with others directly or indirectly controls the manufacturing, processing, or preparation for sale of . . . pork products . . . if the . . . pork products have a total annual wholesale value of eighty million dollars or more for the person’s tax year.” In addition, a person was deemed to be a processor if he “holds an executive position in a processor of pork products or owes a processor of pork products a fiduciary duty, if the processor directly or indirectly controls the processing of pork products having a total annual wholesale value of two hundred sixty million dollars or more.” This disqualification was deemed to extend for two years after the person “relinquishes the position or duty.”

103. Because William Prestage serves as a Director of Smithfield, the intent and effect of this amendment is to confirm that Prestage-Stoecker is a “processor” which is prohibited from

contracting for the raising of swine. This amendment is so narrowly targeted toward plaintiffs that it was widely and jocularly referred to by some in the Iowa General Assembly as the "Stoecker Amendment."

104. Senate File 2309 also amended the civil penalty in Iowa Code § 9H.3 for violations of Iowa Code § 9H.2 from a one-time fine of "not more than \$25,000" to a rolling fine of not more than \$25,000 per day whereby "each day that a violation continues shall be considered a separate offense."

105. Iowa Code § 9H.2A reaffirmed July 1, 2004 as the operative date for the amendments to Iowa Code § 9H.2.

106. The raising of feeder pigs, their introduction from out-of-state into Iowa, the contracting for their care and feeding in Iowa, and their being processed in Iowa or exported from there for processing in other states constitutes interstate commerce. Those 260 farms who continue to contract with Prestage-Stoecker under an arrangement that allows Smithfield, through Murphy Farms, LLC, to receive the economic benefit from swine finishing in Iowa are providing services in interstate commerce.

107. The purpose and effect of Iowa Code § 9H.2 is to prevent the existing business of an out-of-state corporation, while permitting entities organized under the laws of Iowa, or other cooperatives which are owned in part by entities organized under the laws of Iowa, to engage in this business so long as they contract with Iowa residents actively engaged in farming.

108. In other words, the facial intent of Iowa Code § 9H.2 (2002) is to discriminate against interstate commerce and, further, to establish a protectionist regime for Iowa cooperative associations and residents under color of state law.



109. Contract farms in Iowa are generally capitalized by the farmers using their long-term (10-year) finishing contracts as collateral. The amount of investment and working capital needed for a finishing farm is approximately \$180 per head. Banks will not lend to hog farmers solely on the security of their farmland or their herds. These contracts are thus critical to the continued financial survival of these Iowa farms.

110. Finishing contracts with Prestage-Stoecker are based on the square footage of containment and production costs. Hence, they provide a reliable stream of income for debt service that could not be obtained if the farmers owned the pigs they finished and then sold them on spot markets. The network of 260 highly-capitalized finishing farms is a valuable asset that can be expected to attract venture capital to sustain it under the exemption for Iowa cooperative associations and Iowa residents. Clearly, these contract farms will have a strong economic incentive to take advantage of this exemption to service existing debt. It is therefore demonstrable that it is the intent and effect of Iowa Code § 9H.2 to divest the integrated Iowa hog production business from an out-of-state entity (Smithfield) and transfer it to one or more Iowa-affiliated entities.

111. Although the stated statutory purpose of Iowa Code § 9H.2 "is to preserve private enterprise, prevent monopoly, and also to protect consumers," the burden on interstate commerce created by this statute clearly exceeds its putative local benefits.

112. A recent study conducted by the National Pork Producers Council found the cost of non-conformities originating from the production level to be approximately \$10 per head. There is additional cost of approximately \$2.30 per head associated with non-conformities at the packer and processing levels. These losses provide a material incentive of more than 10% of the

value of the hog to strive to improve pork quality. Use of a coordinated or integrated pork production and processing system is a proven method to reduce this cost.

113. Consumers are not protected by policies which ultimately increase prices due to non-conformities or which make pork products less traceable and less uniform in their quality.

114. The putative purpose of preserving private enterprise is also not served by Iowa Code § 9H.2 because this statute now restricts the right of Prestage-Stoecker's 260 contract farms to choose to operate under the relative stability of finishing service contracts, and it deprives all entities other than those involving Iowa cooperative associations contracting with Iowa residents from participating in the finishing market if they are affiliated – no matter how remotely – with a processor. Thus, Iowa Code § 9H.2 tends to restrict private enterprise rather than preserve it.

115. Supporters of Iowa Code § 9H.2 have argued that it was intended to preserve the spot market, so that those farmers choosing to finish their own pigs would have a functioning market. However, meat sold in the genetically and nutritionally controlled, traceable, and branded market does not come to or from the spot market. Prohibiting contracting for meat in the branded market does not affect the viability of the spot market. Moreover, Iowa has at this time a very competitive spot market for hogs. While a state may pass legislation to guard against future evils, when that legislation (as Iowa Code § 9H.2 does here) materially burdens interstate commerce, the fear of future, hypothetical, and speculative harms cannot carry significant weight when the burden on interstate commerce is balanced against the putative local benefits.

116. The stated purpose in Iowa Code § 9H.2 of preventing monopoly also has no tie to a present or existing local benefit. Existing economic data do not support the view that

vertical integration – a process almost complete for the poultry market – permits its practitioners to exercise monopoly power. Again, the putative local benefit of preventing the exercise of monopoly power is speculative, hypothetical, and in the future, thereby providing insufficient justification for the present material burden that Iowa Code § 9H.2 imposes on interstate commerce.

117. In the pork industry, the actual benefits of vertical integration favor and accrue to all relevant interests. According to the USDA's Agricultural Economic Report No. 807 (Apr. 2002), vertical coordination benefits farmers, packers, and consumers alike.

118. Not only is the conduct regulated under Iowa Code § 9H.2 interstate commerce, it is interstate commerce that Congress has consciously chosen not to regulate. In passing the 2002 Farm Bill, the U.S. Senate approved the so-called Johnson Amendment, which in its final form would have prevented pork producers from contracting for long-term production services where they had a degree of control equal to day-to-day operational control. This proposed regulation of vertical integration in the pork industry was much more modest than the severe, retroactive prohibitions codified in Iowa Code § 9H.2. Yet after extensive debate in the Senate, the House of Representative conferees refused to accede to it.

119. Should this Court permit the amendments to Iowa Code § 9H.2 to take effect on July 1, 2004, this statute will effect a regulatory taking of Smithfield's, Murphy Farms, LLC's, and Prestage-Stoecker's Iowa business. Not only does Iowa not have a mechanism for compensating this threatened taking, it has a positive rule of law against compensation for the value of a business on the grounds that such value is uncertain and "far too speculative." Kurth v. Iowa Dep't of Transp., 628 N.W.2d 1, 8 (Iowa 2001). The facts and circumstances of this

case make plaintiffs' taking claim presently ripe and suitable for injunctive and declaratory relief.

120. Because Iowa has a dominant share of the United States' hog and pig inventory, a state statute like Iowa Code § 9H.2 that seeks to close such a substantial part of a national market to plaintiffs and their affiliates, which are the largest producers of pork products, is a material and unreasonable burden on interstate commerce.

121. Moreover, Iowa Code § 9H.2 operates as a substantial impairment of Murphy Farms, LLC's contracts with Prestage-Stoecker, and also of Prestage-Stoecker's contracts with its 260 contract farms. None of the parties to these contracts could have reasonably expected that the State would react to losing its lawsuit by so radically intruding upon interstate commerce.

122. Because the purchase price paid by Smithfield for Murphy Farms, Inc. contained a premium for Murphy Farms, Inc.'s Iowa-based operations, the economics of the transaction demonstrate that Smithfield, Murphy Farms, LLC, and Prestage-Stoecker plainly lacked "a fair and appreciable warning of an impending [retroactive] intervention into their agreements." Holiday Inns Franchising, Inc. v. Branstad, 29 F.3d 383, 385 (8th Cir.), *cert. denied sub nom. Iowa v. Holiday Inns Franchising, Inc.*, 513 U.S. 1032 (1994). Furthermore, not only does Iowa Code § 9H.2 constitute a substantial impairment of contract, the State cannot demonstrate a significant and legitimate public purpose such as the remedying of a broad and general social or economic problem. Instead, it prescribed a rule that was limited in effect to contractual obligations, and it did so in a discriminatory matter to address a merely hypothetical or even pretextual harm, with specific animus against a particular out-of-state company and with the

narrowly targeted intent to retroactively abrogate the specific contracts at issue involving plaintiffs.

123. The discriminatory and protectionist purposes and effects of Iowa Code § 9H.2 are consistent with codified statements of public policy in Iowa. For example, the Iowa Agricultural Industry Finance Act, passed by the 1998 General Assembly, has the stated intent that:

this state capture the greatest benefit from opportunities created . . . by encouraging local agricultural producer-led ventures to expand production and processing of high value agricultural products, to organize new business structures within the state to carry out these ventures, and to market and deliver increasingly high value agricultural products to consumers around the world. In carrying out this purpose, state resources . . . shall be used to assure all of the following:

a. That the majority of the wealth created by Iowa agricultural productivity is retained in this state.

. . . .

d. That this state becomes a world model for agricultural producer-based vertical cooperation . . . .

Iowa Code § 15E.203(2) (emphasis added). The policy of this Act is set within a context provided by the legislative finding “that this state is in a period when the economic structure of agriculture and the production, processing, and marketing of agricultural products is undergoing a period of rapid transformation.” Iowa Code § 15E.203(1).

124. This discriminatory and protectionist policy is entirely consistent with the 2002 resolution of the Iowa Farm Bureau, which accounts for nearly 40% of the General Assembly in its membership, that “[f]armers should continue to have the opportunity to both own a packing plant and contract [to] feed or own livestock through a local or regional cooperative.”

125. In sum, the executive and legislative branches in Iowa recognize that vertical integration in the pork industry is inevitable. What the Iowa legislature wishes to do is to insure that Iowans possess the largest possible ownership interest in any vertically integrated pork operation in Iowa to the exclusion of non-Iowans. To accomplish this discriminatory end, Iowa is seeking to directly regulate interstate commerce and is burdening it to an extent that is clearly disproportionate to the putative local benefits. In seeking to accomplish its purposes, Iowa is engaged in the regulation of extraterritorial conduct, is directly and retroactively impairing specific existing contracts, and is effecting a regulatory taking – all in contravention of the Constitution of the United States.

## **COUNT I**

### **Dormant Commerce Clause (Discrimination)**

126. The allegations contained in Paragraphs 1 through 125 are incorporated by reference as if fully set forth herein.

127. Pursuant to Article I, Section 8, Clause 3 of the Constitution of the United States, “Congress shall have Power . . . [t]o regulate Commerce . . . among the several states.”

128. The dormant Commerce Clause prohibits a state from discriminating against interstate commerce by adopting isolationist or protectionist trade policies that treat in-state and out-of-state interests differently to the benefit of the former and at the expense of the latter. This constitutional provision bars a state from shielding local industries or interests from competition in interstate commerce.

129. Economic protectionism includes efforts to favor in-state economic interests over out-of-state interests, as well as to protect local industries by imposing burdens against out-of-state competitors.

130. The dormant Commerce Clause bars states from passing statutes that have an intended discriminatory purpose or effect impairing the flow of interstate commerce. Such statutes constitute a *per se* violation of the Commerce Clause. The Commerce Clause is violated even though the statute does not prefer all Iowans as long as it prefers some Iowans at the expense of non-Iowans.

131. The State of Iowa does not ban vertical integration within its borders. To the contrary, the Iowa General Assembly has stated in Iowa Code § 15E.203(2) that it intends Iowa to become an international model for agricultural producer-based vertical integration. Governor Vilsack in his vision for the State's future has likewise recognized the principle that "[o]pen markets . . . will diminish in favor of highly integrated systems driven by consumer demand" and embraced the concept that "these changes provide a unique opportunity for Iowa to reinvent agriculture and its role in feeding the world." Iowa 2010 – The New Face of Iowa, *supra*.

132. As further demonstrated by Iowa Code § 15E.203(1), there is an official state policy to discriminate against out-of-state interests by seeking to guarantee that "the majority of the wealth created by Iowa agricultural productivity is retained in this state." The intent and effect of Iowa Code § 9H.2 is to eliminate Smithfield from doing business in Iowa and allow only Iowa cooperative associations or regional cooperatives with at least one such Iowa entity as an owner contracting with Iowa residents to benefit from the vertical integration business model. This is the equivalent of saying that only Iowans can practice this business model in Iowa.

133. Iowa Code § 9H.2 (2002), facially and as applied, discriminates against out-of-state interests to the benefit of in-state interests both by its terms and in its intended effects. This economic protectionism and discrimination is a *per se* violation of the dormant Commerce Clause of the Constitution of the United States. Furthermore, this statute serves no legitimate, compelling state interest, nor is it reasonably limited to what is necessary to advance such an interest.

## COUNT II

### **Dormant Commerce Clause (Direct Regulation of Interstate Commerce)**

134. The allegations contained in Paragraphs 1 through 133 are incorporated by reference as if fully set forth herein.

135. Under the dormant Commerce Clause, states are prohibited from directly regulating interstate commerce of a character that should be the subject of uniform national regulation.

136. Here, the breeding of hogs, the raising of feeder pigs, their transportation from out-of-state by processors, the contracting for their care and feeding in Iowa between Murphy Farms, LLC and Prestage-Stoecker, and their being processed in Iowa or elsewhere for consumption almost entirely outside Iowa constitutes interstate commerce. The 260 farms in Iowa who voluntarily contract with Prestage-Stoecker to raise hogs under a mutually beneficial arrangement that allocates the production risk to Murphy Farms, LLC and allows Smithfield, through Murphy Farms, LLC, to receive a part of the economic benefit from swine finishing in Iowa provide services in interstate commerce.

137. This is interstate commerce whose regulation requires national uniformity.



138. Under Iowa Code § 9H.2 (2002), Smithfield cannot own a swine operation in Iowa, cannot finance a swine operation in Iowa, cannot receive the net revenue from a swine operation in Iowa, and cannot obtain production benefits associated with the raising of swine by directly or indirectly assuming production risks. Murphy Farms, LLC is also banned from engaging in these activities in interstate commerce due to its affiliation with Smithfield.

139. Moreover, under Iowa Code § 9H.1(19) (2002), Prestage-Stoecker is banned from engaging in these activities in interstate commerce because William Prestage serves on Smithfield's Board of Directors and owes a fiduciary duty to Smithfield, a corporation whose pork products exceeded a total annual wholesale value of \$80 million in 2001.

140. Smithfield and Murphy Farms, LLC want to continue transporting hogs through interstate commerce into Iowa for care and feeding in that state, and for processing in that state or elsewhere.

141. The amendment of Iowa Code § 9H.2 (2002) to prohibit plaintiffs from continuing to engage in this conduct was in retaliation against Smithfield's and Prestage-Stoecker's having prevailed in State of Iowa ex rel. Miller v. Smithfield, Equity No. EQCV 016629 (Dist. Ct. Humboldt County).

142. The stated purpose and inevitable effect of Iowa Code § 9H.2 is to prevent vertical integration in the pork industry in Iowa by non-Iowans. This is not an exercise of traditional local interest such as land title or an exercise of the state police power that has only an incidental effect on interstate commerce. Instead, Iowa Code § 9H.2 represents an attempt to directly regulate interstate commerce *qua* interstate commerce.

143. This represents a *per se* violation of the dormant Commerce Clause of the Constitution of the United States. Furthermore, this statute serves no legitimate, compelling state interest, nor is it reasonably limited to what is necessary to advance such an interest.

### **COUNT III**

#### **Dormant Commerce Clause (Extraterritorial Regulation)**

144. The allegations contained in Paragraphs 1 through 143 are incorporated by reference as if fully set forth herein.

145. The dormant Commerce Clause prohibits a state from regulating commerce wholly outside a state's borders or requiring a business to conduct its out-of-state commerce in a certain way or according to in-state standards.

146. Here, Murphy Farms, LLC and Prestage-Stoecker could continue with their business if they were not affiliated in any degree of remoteness with someone who processes pork anywhere in the world.

147. Under Iowa Code § 9H.2, the activity that triggers the statutory bar of Iowa Code § 9H.2 with respect to plaintiffs is the act of processing non-Iowa hogs outside of Iowa. The nexus between Iowa and the prohibited out-of-state activity is too remote to support the extraterritorial regulation being attempted.

148. Iowa Code § 9H.2 (2002) represents direct extraterritorial regulation of interstate commerce, which is a *per se* violation of the dormant Commerce Clause of the Constitution of the United States. This statute serves no legitimate, compelling state interest, nor is it reasonably limited to what is necessary to advance such an interest.

## **COUNT IV**

### **Dormant Commerce Clause (Unreasonable Burden on Interstate Commerce)**

149. The allegations contained in Paragraphs 1 through 148 are incorporated by reference as if fully set forth herein.

150. Even if Iowa Code § 9H.2 (2002) were to be viewed as an evenhanded regulation of intrastate commerce or an exercise of state power that only incidentally affects interstate commerce, this statute imposes a substantial and detrimental burden on interstate commerce that clearly exceeds the putative local benefits.

151. Because Iowa has a dominant share of the United States' hog inventory, the effect of closing this market to all but Iowa-affiliated cooperatives creates a burden on interstate commerce that is unreasonable when balanced against the putative local benefits of preserving free and private enterprise, preventing monopoly power, and protecting consumers.

152. Moreover, Iowa Code § 9H.2 does not, in fact, advance those putative purposes and/or is directed against harms that are future, hypothetical, and speculative, if not simply pretextual.

## **COUNT V**

### **Impairment of Contracts (Article I, Section 10)**

153. The allegations contained in Paragraphs 1 through 152 are incorporated by reference as if fully set forth herein.

154. Article I, Section 10, Clause 1 of the Constitution of the United States provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts."

155. Iowa Code § 9H.2 (2002) substantially impairs plaintiffs' existing contractual relationships.

156. The 2002 amendments to Iowa Code § 9H.2 make these contracts illegal, resulting in a substantial impairment to plaintiffs' reasonable investment-based expectations.

157. There is no significant and/or legitimate state interest that would justify Iowa Code § 9H.2's total nullification of plaintiffs' contract rights.

## **COUNT VI**

### **Regulatory Taking (Amendments V & XIV)**

158. The allegations contained in Paragraphs 1 through 157 are incorporated by reference as if fully set forth herein.

159. Amendment V to the Constitution of the United States provides in relevant part that private property "shall [not] . . . be taken for public use, without just compensation." This amendment is applicable against the State of Iowa by virtue of the Fourteenth Amendment.

160. Plaintiffs' takings claim is ripe for adjudication because Iowa Code § 9H.2 was signed into law and because it would be futile to pursue remedies in state court given the Supreme Court of Iowa's holding in Kurth v. Iowa Dep't of Transp., 628 N.W.2d 1 (Iowa 2001), that the value of a business is not compensable because it is too uncertain and speculative to be reliably calculated. The narrowly tailored and severely retroactive purpose and effect of Iowa Code § 9H.2 entitles plaintiffs to permanent injunctive relief.

161. Iowa Code § 9H.2 (2002) in its narrow focus and retroactive application violates basic principles of fairness and transfers the financial and economic benefits of vertical

integration from out-of-state processors like Smithfield to Iowa cooperative associations and residents.

162. The outright ban against plaintiffs' operations codified in Iowa Code § 9H.2 interferes with plaintiffs' reasonable investment-backed expectations inasmuch as plaintiffs will not be able to do business in Iowa, will lose profits and the benefits of the premiums that they have paid in order to secure an operational foothold in Iowa, and suffer diminished value to their remaining property interests within the State.

#### **PRAYER FOR RELIEF**

WHEREFORE, plaintiffs Smithfield Foods, Inc., Murphy Farms, LLC, and Prestage-Stoecker Farms, Inc. pray for the following relief:

1. A declaration that Iowa Code § 9H.2 (2002) is unconstitutional on its face and as applied under Article I, Section 8; Article I, Section 10; and the Fifth and Fourteenth Amendments of the Constitution of the United States;
  2. Appropriate injunctive relief prospectively preventing defendant from enforcing Iowa Code Chapter 9H against plaintiffs;
  3. An award of reasonable attorneys' fees and costs pursuant to 42 U.S.C. § 1988;
- and
4. Such other and further relief as this Court may deem appropriate.

Respectfully submitted,



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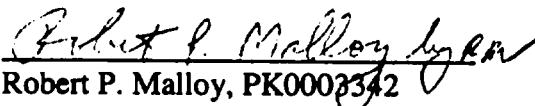
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